DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92037

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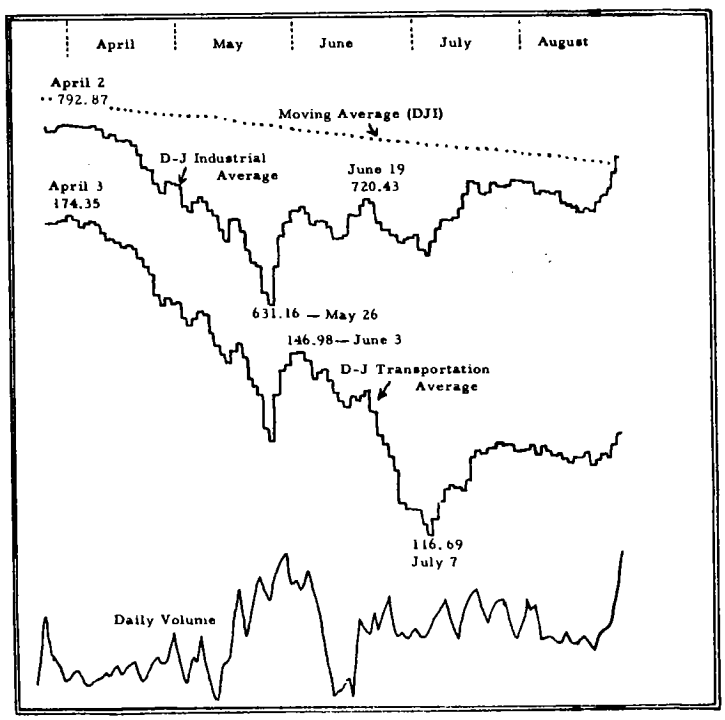
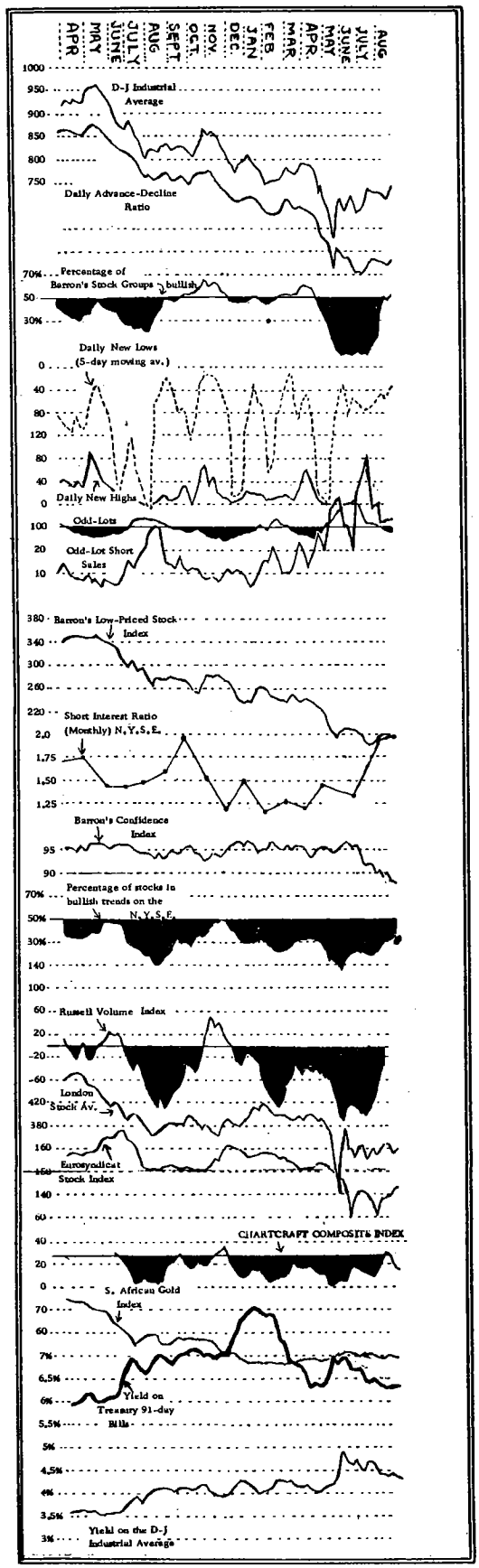
THE MARKET: This primary bear market, still in its second and most deceptive phase, is continuing to make a mockery of the "crystal ball gazers". For a year-and-a-half the bear market headed down, going further, longer and more relentlessly than 99% of Wall Street thought possible. As a result, the professional, the funds, and the public were left with the worst losses in 32 years.

Then on May 26 the Averages recorded their last confirmed lows. Those lows were 631.16 for Industrials, 131.53 for Transports. A sharp rally ensued, taking the Averages (see chart) to 713.96 on Industrials, 146.98 on Transports. On June 9 a new decline started, and this time the Transports plunged to a July 7 low of 116.69. The Industrials refused by a wide margin to confirm.

During this entire period I warned (and I continue to warn) that the primary trend was down. More recently, as the various investment services switched to various degrees of bullishness and bearishness, I cautioned against the kind of soothsaying which specifies that "the market will rise 106 points, then drop 237 points by September 15". That kind of prognostication simply does not work in the stock market, and the investment advisor who "hits it on the head" once is usually in line to become the wrongest man on Wall Street during the next try.

In the last Letter (470) I cautioned about accepting the technical condition of the market as if the technical condition alone was of overriding importance. I will again issue that warning. We are in the second phase of a bear market, and the market is currently in its third month of upward correction. During the last three months roughly 5.5 million shares have been added to the short position by "Johnny-come-lately" bears, and Wall Street is now in the process (following 18 months of administering a beating to the bulls) of wiping out the amateur pessimists. The latest short interest ratio figure on the N.Y.S.E. is 2.0, and although this is not of great importance during a bear market, it is indicative of a vulnerable




D-J Industrial Average
Daily Advance-Decline Ratio
Percentage of Barron's Stock Groups bullish
Daily New Lows (5-day moving av.)
Daily New Highs
Odd-Lots
Odd-Lot Short Sales
Barron's Low-Priced Stock Index
Short Interest Ratio (Monthly) N.Y.S.E.
Barron's Confidence Index
Percentage of stocks in bullish trends on the N.Y.S.E.
Russell Volume Index
London Stock Av.
Eurosyndicat Stock Index
CHARTCRAFT COMPOSITE INDEX
S. African Gold Index
Yield on Treasury 91-day Bills
Yield on the D-J Industrial Average

 bear position, and that vulnerability, for the moment, is being converted into short covering and shattered bank accounts. The short interest in the 30 Dow Industrials was 1.40 for July, not a high figure by historical standards, but enough to add impetus to the rally.

Everyone is now aware that the rally has established a series of rising peaks for the Industrials, 713.96 on June 3, 720.43 on June 19, 735.08 on July 17, 735.56 on July 28, and new highs above 745 last week. But almost no one is recognizing that not one of those successive highs has been confirmed by the Transportation Average, which is still 15 points below its initial recovery peak of 146.98 (June 3). Dow's Theory is specific in stating that a movement of one Average, unconfirmed by the other, is meaningless for predictive purposes (and more often than not deceptive). As far as Dow's Theory is concerned, this advance is an important secondary (upward) correction in a continuing bear market. The rally is impressive but dangerous, and the danger is underscored by the persistent refusal of Transports to confirm the upward progress of the senior Average.

I have said many times before that bear markets, by their nature, produce losses in all segments of Wall Street. All during 1969 and 1970 the bear brought havoc to shareholders. Now with 20 million shares sold short on the Big Board alone, the market is wreaking vengeance on late-arrival bears. Ultimately, when the short position is sufficiently ravaged, the primary forces will reassert themselves, and the market will once again head for (and through) the lows. In the meantime, I urge subscribers to enjoy their vacations, avoid mixing with the bear (either in its rallying or declining phases), and be glad you were neither long during 1969 to mid-1970, nor short after mid-1970. One of the most pathetic sights of today is the advisory services twisting belatedly first one way, then the other, as they try to adjust to the market. To adjust with them, during this bear market, has usually meant a loss of part or all of one's capital.

SINCE THE BEGINNING: The accompanying chart on page 3 first appeared (to my knowledge) in Cycle magazine. It was recently re-published by Gilbert Haas & Co., although it has appeared several times previously in Dow Theory Letters. The chart was put together from the most reliable averages available through 1896, and from that date on the Dow Industrial Average was used.

The center line of this giant rising channel may be termed the growth line, and this has been rising recently at the rate of about 8 points a year. Many readers will immediately ask, "What about inflation?" and here I agree with Robert Rhea that the Averages take everything into account including inflation. Therefore, there is no need to adjust the Industrial Average for inflation, any more than there is a need to adjust it during hard times for deflation. The reason for this is that during times of inflation, it is usual for investors to pay higher price-earnings ratios for stocks, and these higher P/E's are automatically translated into a higher price for the Dow.

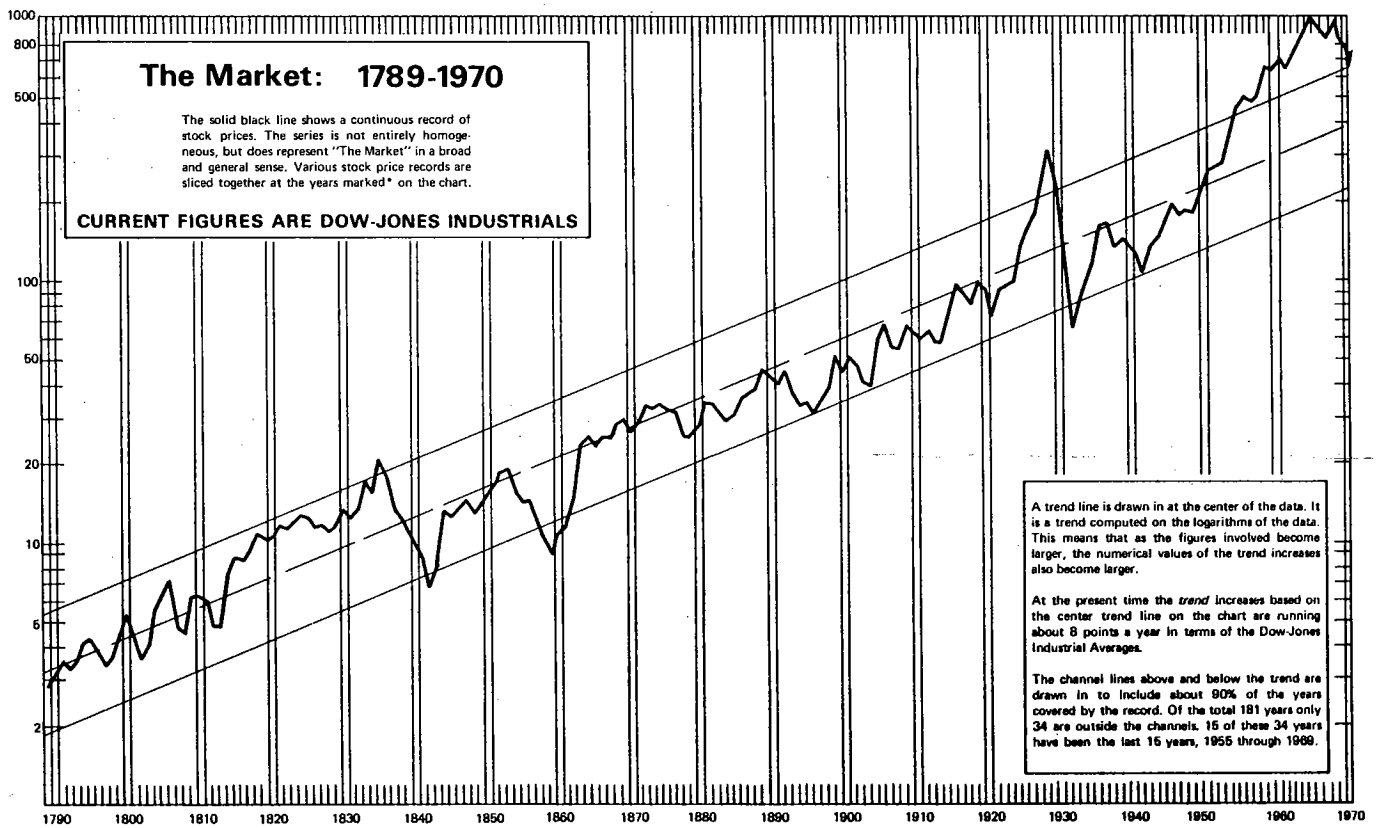
It is interesting to note that about 90% of the 181 years shown included price movements within the channel limits, while only 34 years contained price movements outside the channel lines. During the mid-1830's, the market roared under President Jackson, and volume jumped from a record 1,000 shares per day (!) to 5,000 shares per day in 1835. It was the first big bull market in American history, and during 1834 and '35 the Average moved above the trendline for the first time. The aftermath was a vicious bear market which, by 1842, took the Average below the lower limits of the channel.

The next super-bull market is too well-known to need recounting, and it was the 1921-29 affair. During 1928 and 1929 the Average again burst above the upper channel limits, and again the aftermath was the same. A disastrous bear market took the Dow below the lower channel limits in 1932 (with the Dow at an extreme low of 41).

Of the 18 years in which the Average was above the upper limits of the channel, 15 of them have been during the last 15 years (or since 1955). One obviously wonders whether the aftermath of the great bull market of 1949 to 1966 will again be a plunge by the Dow below the lower channel limits. If this were to happen, the Dow could end up in the 225 area.

From another standpoint, we might expect a good deal more on the downside from the current bear market. With the help of Mr. David Wintroath of San Diego, I completed a study of all the bull and bear markets since 1896, showing percent rise in the Dow Industrials for each bull market — and the percentage of that bull market rise which was erased by each succeeding bear market. The figures are included below:

Bull Market	Range of Bull Market	% of Bull Market Rise	Bear Market Following	Bear Market Range	% of Preceding Bull erased by Bear
1896-99	29 to 78	162%	1899-00	78 to 53	52%
1900-01	53 to 78	25%	1901-03	78 to 42	143%
1903-06	42 to 103	144%	1906-07	103 to 53	82%
1907-09	53 to 100	89%	1909-10	100 to 73	57%
1910-12	73 to 94	28%	1912-14	94 to 53	198%


The Market: 1789-1970
The solid black line shows a continuous record of stock prices. The series is not entirely homogeneous, but does represent "The Market" in a broad and general sense. Various stock price records are sliced together at the years marked* on the chart.
CURRENT FIGURES ARE DOW-JONES INDUSTRIALS
A trend line is drawn in at the center of the data. It is a trend computed on the logarithms of the data. This means that as the figures involved become larger, the numerical values of the trend increases also become larger.
At the present time the trend increases based on the center trend line on the chart are running about 8 points a year in terms of the Dow-Jones Industrial Averages.
The channel lines above and below the trend are drawn in to include about 90% of the years covered by the record. Of the total 181 years only 34 are outside the channels. 15 of these 34 years have been the last 15 years, 1955 through 1969.
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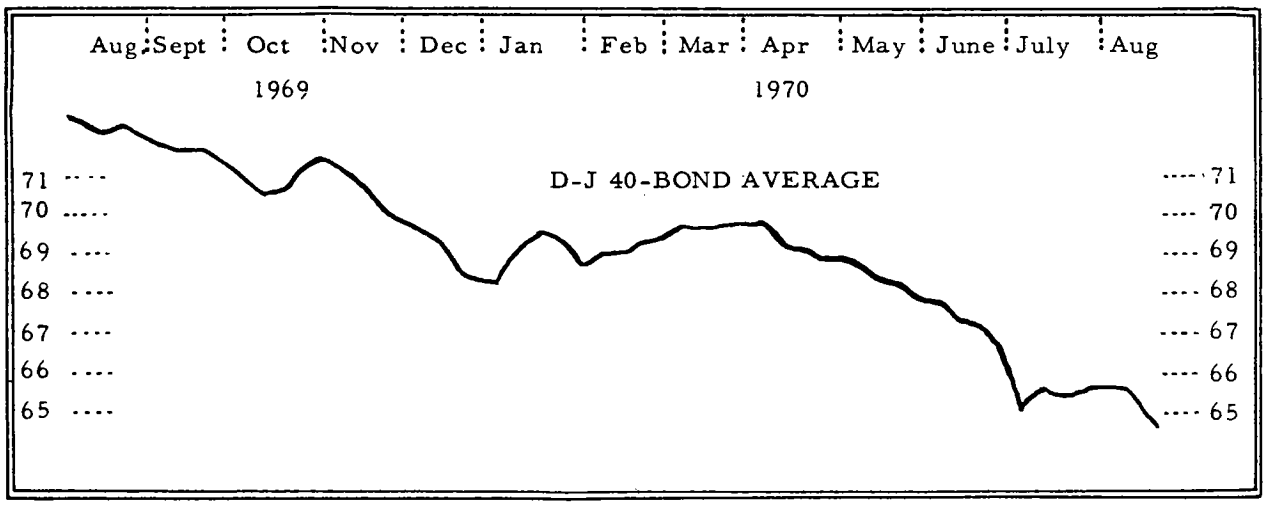
Bull Market	Range of Bull Market	% of Bull Market Rise	Bear Market Following	Bear Market Range	% of Preceding Bull erased by Bear
1914-16	53 to 110	107%	1916-17	110 to 66	77%
1917-19	66 to 119	91%	1919-21	119 to 64	104%
1921-29	64 to 381	495%	1929-32	381 to 41	115%
1932-37	41 to 194	375%	1937-42	194 to 92	67%
1942-46	92 to 212	130%	1946-49	212 to 161	42%
1949-66	161 to 995	520%	1966-70(so far)	995 to 631	43% (so far)

(Average bear erasure % not including 1966-70 ..... 90%)

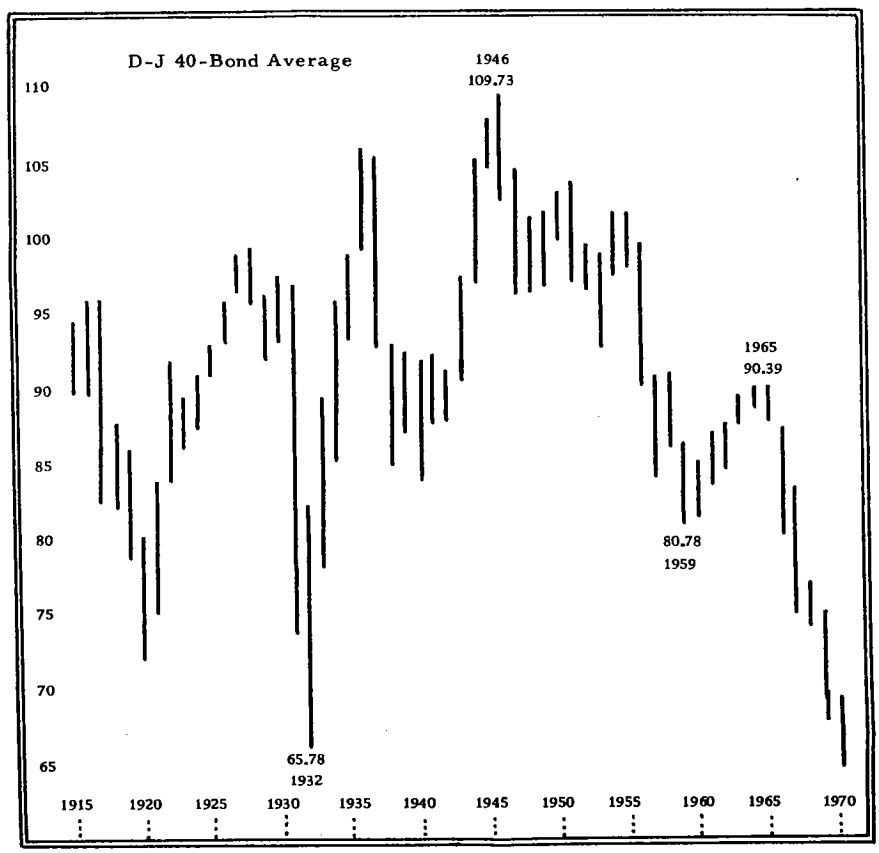
In other words, the average percentage erasure of the previous bull market gains, taking 10 previous bear markets into account, was 90%. If this bear market were to wipe out 90% of the 834 points gained between 1949 and 1966, the bear market would decline to 240. Now personally, I am not particularly taken with the average percentage, but I do think it significant that all the bear markets listed with the two exceptions of 1907-09 and 1946-49 succeeded in erasing two-thirds or more of the preceding bull market gains. If the current bear market were to erase two-thirds of the gains since 1949, the Dow would get down to 445.

The interesting thing about statistics is that they don't necessarily predict anything. At best, the kind of figures I present above produce some kind of odds. Now odds are hardly the perfect answer in the stock market. But they are the best we have and they are alot better than nothing. They at least show what can happen, and they throw much cold water on hopes and guesses about what "cannot possibly happen". The odds, based on 10 previous bear markets show that 8 out of 10 of those bear market wiped out two-thirds or better of the previous bull market gains. Those odds should be enough to cause subscribers to have respect for the current primary bear market. And when friends tell you that you are "an old fuddy-duddy" for playing it safe to the end, you might show them these statistics.



BONDS: For every thousand stock holders, there are perhaps two or three market students. For every thousand market students, there are perhaps ten students of the bond market. Yet the amount of bonds outstanding dwarfs the amount of stocks outstanding. The amount of bond trading weekly surpasses the amount of stock trading weekly. A sick bond market often precedes a sick stock market, and a declining bond market can put the brakes on the economy as quickly as a declining stock market.

One of the oldest and best bond indexes is the D-J 40-Bond Average. It is made up of 10 high-grade rail bonds, 10 second-grade rail bonds, 10 industrial bonds and 10 utility bonds. I include a long-term annual chart of the 40-Bonds, a chart going back to 1915, which was the first year of its introduction (figures courtesy of C. Coleman Petty, of Louisville, Kentucky, one of the few real bond students around). Note on the chart that there was a major bear market in bonds during 1915 to 1920, a bull market from 1920 to 1928, a bear market from 1928 to 1942, a bull market from 1942 to 1946. And from 1946 (just after the end of World War II) to the present, we have been in the greatest bear market in bonds in history.



There is no need to go into the ramifications of "why" the bear market. Suffice it to say that between 1942 and 1970 the U.S. piled up the greatest mass of debt ever seen by man, the bond market began sagging, then declining in earnest, and more lately collapsing. In July, 1970, although almost no one realized it, the 40-Bonds produced an event of historic interest. The 40-Bond Average penetrated the extreme low (65.78) of 1932 (during which time the nation was in the depths of its worst depression), thereby dropping to its lowest level on record. The July, 1970 low was 64.85.

From the July low of 64.85 (see weekly chart) the 40-Bonds, amid great fanfare ("A new bull market in bonds has started") the 40-Bonds rallied to a peak of 65.74 on August 7, 1970. In the few weeks since then, pressure has hit the bond market again. Massive new issues now glut the bond calendar, and the 40-Bonds on August 20 sank to 64.36, its lowest point in history. Two days before, the Fed issued its new rulings on bank reserves and commercial paper reserves (could somebody at the Fed follow the 40-Bonds?). At any rate, those who think that an impressive bond rally has been underway had best revise their thinking.

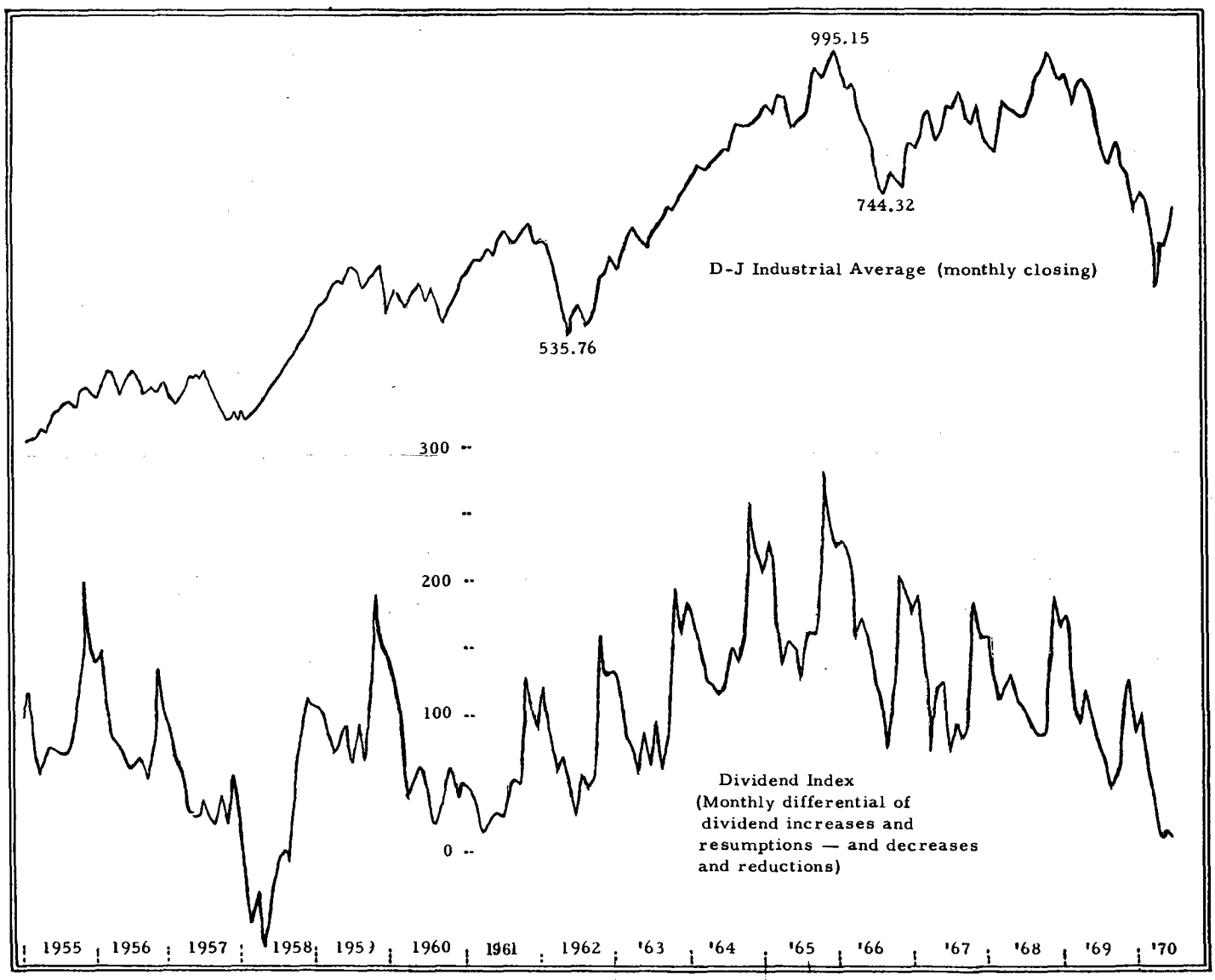
The pressure is still on in the bond market. And this writer thinks that there will be more pressure, and greater pressure to come.

DIVIDENDS ON THE LINE: I have been talking for many months now about the liquidity crisis and the coming squeeze on dividends. This chart, which last appeared in Letter 463, is (as far as I know) the only chart published anywhere which deals with the trend of dividends. Since what a stock yields (dividends) is a prime fundamental under the Dow Theory, I consider this chart to be of utmost importance.

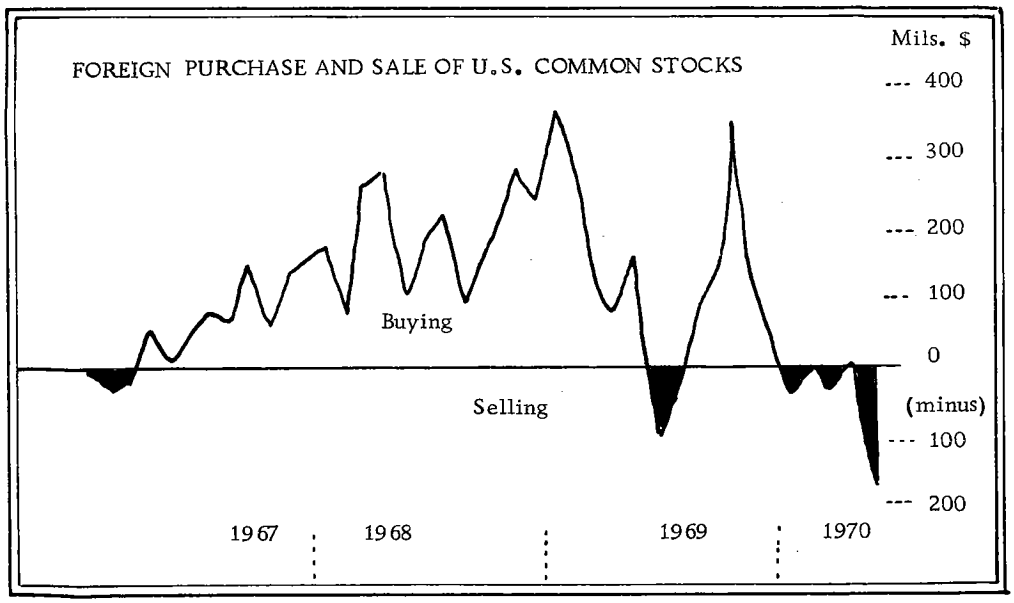
Each month Standard & Poor tabulates the dividend declarations of over 2,000 leading corporations. What I have done is to take the monthly figures and tabulate them as follows: monthly dividend increases and resumptions are lumped together — and monthly decreases and omissions are lumped together. I then compute the pluralities. For instance, in July, 1970, there were 63 increases and resumptions, 51 omissions and decreases. This gave a plurality of 12. This figure is charted. As seen on the chart, the latest July figure is the worst of any July since 1958.

The steady erosion in the total dividend product of U.S. corporations is obviously continuing. If the trend of illiquidity continues (which it appears to be doing), I would expect the dividend tabulations to start running into the minus column within a few months. This is a leading indication that a primary bear market is still in force.

There are always investors who say, "The devil with the market, I have good stocks, and as long as they pay the dividend, I don't care what happens. They'll come back; they always do." These are the people who have not yet been unduly disturbed by the bear market's ravages. I believe they will very definitely be disturbed as the dividends in their stocks are cut and omitted. That process, however, may not occur until the third phase of this primary bear market.



EXIT THE FOREIGNERS:



In the last Letter I wrote about our possibly disastrous coming budget deficit. I mentioned that it could be considerably above the $15 billion which the dyed-in-the-wool pessimists are now talking about. Along with the budget deficit, the balance of international payments presents a great problem. Dollars continue to pile up abroad. The balance-of-payments deficit may have been as much as $5 billion during the first half of 1970. During June, alone, official European currency reserves (which are mostly in dollars) rose $1.6 billion, with the largest gains accruing to Switzerland and Germany. Such dollars are a prime source of worry to Washington, since these dollars can be presented to the U.S. Treasury for purchase of gold.

Now, from another source the pile-up of dollars is intensifying. For years, foreigners have invested their money in U.S. common stocks. Since 1967, the only real selling on balance from foreigners came during a short spate in mid-1967. Then in late 1969 (see chart) the tide of buying reversed and headed down. By 1970 foreigners, their confidence damaged by the long bear market, started selling on balance. The selling of U.S. securities has continued all through 1970, hitting its highest level in four years during May (the last figure shown on the chart).

When foreigners sell U.S. stocks they can either keep the money here in the form of bonds or Treasury securities or they can take their money out of the country. It is certain that a good percentage of the dollars received for stocks sold are being pulled out of the U.S. These dollars will be sold for foreign currencies or held in foreign central banks. Thus, the current trend of common stock sales by foreigners is building up more dollars in such countries as Switzerland, France, Germany, England, etc. The mountain of dollars with which foreigners can purchase U.S. gold continues to rise.

As a final consideration, as long as inflation continues in this country, foreigners have an incentive to get out of dollars and into more stable currencies. Thus, foreigners have a double incentive to pull out their money, first, the U.S. stock market has dampened their enthusiasm for holding equities here; second U.S. inflation provides an incentive to get rid of U.S. dollars completely.

LIQUIDITY: Below is a letter from subscriber Dale Hunter of Sacramento. I thought it was interesting enough to publish: "On Page 919 (and again on 937) of the paper back edition of The Arms of Krupp, by William Manchester, two lines came through as though from one of your recent letters.

"They were quotes from an article by Johannes Schroder in Handselsblatt directed to Alfried Krupp. According to Manchester, Schroder had graduated from three universities; was for a time 'die Firmas Finanzdirektor , had keenest financial mind in Essen after Loser', and 'In 1962 was among the half dozen most respected economists in the Fuhr'.

"The lines read: 'One thing must be clear: Liquidity is expensive , but illiquidity much more so, because it destroys the very existence of a firm.'

"At the time the firm was most illiquid but Alfried did not get the message in time, if at all."